United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

ORIGINAL

74-2215

United States Court of Appeals

For the Second Circuit.

NORI SINOTO,

Appellant,

vs.

DEVCO MANAGEMENT, INC. and DEIGHTON O. EDWARDS, JR.,

Appellees.

On Appeal From The United States District Court
For The Southern District of New York

BRIEF FOR APPELLEES

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- X

BRIEF FOR APPELLEES

INTRODUCTORY STATEMENT

This is an action based on four promissory notes issued by the defendant, Devco Management, Inc. (hereinafter referred to as Devco) payable to the order of the plaintiff and guaranteed by the defendant Edwards. The defendants interposed affirmative defenses of failure of consideration and fraud in the procurement of the notes.

THE TRIAL

The plaintiff testified that he first met the defendant, Edwards in October, 1971 (33a) and at that time there were general discussions as to the means of developing a business. He stated that he suggested to Edwards that the feasibility of a minority owned company engaging in the waste recovery business should be explored

(35a). There was some activity between the parties and a number of corporations but nothing was accomplished (33a). The time the parties were seeking to create a business, the plaintiff represented six other companies as a finder or broker working only on a contingency fee basis (44a).

On March 16, 1972, Edwards organized Devco and retained all of its capital stock until July 1972 (77a).

In April, 1972, the plaintiff was experiencing financial difficulties and he asked Edwards for assistance (44a). Edwards made some efforts to procure a loan for the plaintiff but was not successful in raising funds for the plaintiff (60a). Edwards had no personal assets at this time nor was Devco any more than an empty shell of a corporation (62a).

Subsequently the plaintiff and Edwards arrived at an arrangement to assist the plaintiff through his financial difficulties whereby Devco would issue four notes, each in the sum of $12,500 payable to the order of the plaintiff and guaranteed by Edwards. It was understood by both parties that the notes were only to be used as an accommodation and were not to be discounted, pledged or presented for payment (51a, 63a). It was understood that there was nothing behind the notes. The sole purpose for the issuance of the notes were to exhibit

them to a friend of the plaintiffs to give evidence that he had some assets and so to convince such third party to make a loan to the plaintiff (64a, 79a).

On April 26, 1972 the four notes were executed.

The plaintiff was unable to raise any money on the notes as the parties had anticipated. He testified to attempting to negotiate the notes at Bankers Trust Co. and that in so doing he caused the bank officer to call Edwards for his consent to collateralize the notes. No consent was given by Edwards (122a-124a).

The notes were presented for payment at maturity and payment was refused.

No evidence was offered by the plaintiff of a contribution either in cash or services to Devco other than a vague suggestion to Edwards, prior to the formation of Devco, that the waste recovery industry should be considered as a promising field.

The testimony of the plaintiff that he was promised a 50% interest in Devco was denied by Edwards. If the plaintiff were to be given a 50 per cent interest and if some substantial per cent were to be given to a potential investor, the very purpose and concept of Devco as a block owned corporation would be destroyed (108a).

POINT I

THE DEFENDANTS HAVE SUSTAINED THEIR BURDEN OF PROOF

It is axiomatic that when an affirmative defense is pleaded, it is incumbent upon the defendant to prove his contention and, once such proof has been offered, the burden shifts to the plaintiff to refute such contention. The defendants offered two affirmative defenses to this action, failure of consideration and fraud in the procurement.

The trial court did not reject these contentions, but basing its decision on the factual situation as presented, primarily by the plaintiff, found that the defendants indeed had sustained their burden of proof as pleaded.

That there was an utter failure of consideration for the notes is apparent from all of the testimony. The plaintiff offered no evidence of having rendered any service or capital contribution to Devco. The notes were issued approximately one month after the formation of the corporation. That the parties agreed that the plaintiff had earned $50,000 from a worthless corporation in that brief period defies credibility and lends credence to the arrangement between the parties as to the purpose of the notes.

In Hilton v. Correa, 193 N.Y. Supp 2d 543, the court states

> "The absence or failure of consideration may be shown as between the original parties to a negotiable instrument and should be pleaded as an affirmative defense."

In an earlier case, Boohstaner v. Jayne, 60 N.Y. 146 the court held that recovery may not be had as between original parties unless a consideration is shown.

Once the defendant has proven a lack of consideration, the burden shifts to the plaintiff to establish consideration. Pash v. Wagner, 151 N.Y. Supp 2d 411, Davis v. Sisti 148 N.Y. Supp 2d 76.

This position is not available against a holder in due course, as the trial court so correctly stated. It can only be raised between the original parties to the instrument and proof may be made of the consideration and of such facts attending to the making and delivery of the note as are not inconsistent with the instrument. Kouka College v. Ray, 167 N.Y. 96.

Section 3-408 of the Uniform Commercial Code is clear on this point:

> "Want or failure of consideration is a defense as against any person not having the rights of a holder in due cause except that no consideration is necessary for an instrument given in payment of or as security for an antecedent obligation of any kind."

Thus, there being no consideration, not even the proverbial "pepper corn", the instruments must be deemed invalid.

The trial court did find confusion surrounding the issuance of the notes. However, sifting through all of the verbiage, he came to the correct conclusion that these notes were never intended to be used as conventional negotiable instruments, but were restricted only to be exhibited for whatever persuasive power they might exert on a potential lender. The trier of the facts based his decision from the words of the plaintiff which when stripped of the lengthy and circuituitous language clearly shows the intention of the parties.

POINT II

THE TRIAL COURT PROPERLY ADMITTED PAROL TESTIMONY TO SHOW THE INTENT OF THE PARTIES

Again it is axiomatic that when fraud in the procurement is pleaded as an affirmative defense, parol testimony may be introduced to explain the circumstances surrounding the execution and delivery of the instrument. If this were not a basic tenet, fraudulent practices would be unassailable.

Richardson on Evidence, Section 585 and 586 clearly enunciates this principle:

"Par. 585: In all cases in which a want of consideration is available as a defense, parol evidence is admissible to show that an apparently valid obligation in writing was given without consideration to support it. Similarly, parol evidence is admissible to prove that there was a valid consideration for the note or other obligation in question."

"Par. 586: Parol evidence is admissible to prove that an apparently valid contract in writing is unenforceable by reason of the fact that the consent of one of the parties was obtained by fraud, mistake, duress or undue experience.

In Higgins v. Ridgway, 153 N.Y. 130, it was held:

"In an action to show there is no consideration for a note or that the note was given conditionally, parol evidence is competent to show the true condition which existed at the time."

To the same effect see Benton v. Martin, 52 N.Y. 570, Boohstaver v. Jayne, supra, Guerson v. Mason, 60 N.Y. 394, Juilliard v. Chaffee 92 N.Y. 529.

The authorities cited in appellant's brief holding that oral testimony may not be introduced to vary or explain the terms of a note are inapposite. Each of the cases cited by appellant concerns itself with a banking institution. Banks are an exception to the general rule. In each instance the protection of the bank as a public institution was paramount and the right of the stockholders and depositors must be protected. This is a narrow, but salutory concept, having no relevance to the facts in the present case.

The testimony of the parties is abundantly clear as to what their intent was and what the nature of the notes was. In presenting the notes for payment, the plaintiff acted contrary to the intent and purposes of the notes and perpetrated a breach of the conditions surrounding the making of the notes. That the trial court characterized the notes as "unconventional" rather than fraudulent is immaterial. The important fact is that the court understood and gave credence to the expressed intention of the parties.

POINT III

THERE IS NO DOCTRINE OF ESTOPPEL AFFECTING THE DEFENDANTS FROM ASSERTING FRAUD

The authorities cited by appellant to support Point III in his brief are inapposite. The cases relate solely to banking institutions. The courts will not permit a bank, which is a public institution, to be a party to an illegal arrangement and thereby penalize its depositors and stockholders. The cases do not relate to dealings between private individuals.

In Bay Parkway National Bank v. Shalom 270 N.Y. 172, cited by appellant in its brief, the court states:

> "The general rule also is that courts do not aid either party to an illegal contract."

However, the court went on to state the exception that

this principle will not apply against a banking institution.

The facts are clear, if the defendants are estopped from asserting this defense, the plaintiff must likewise be estopped from prosecuting this action.

CONCLUSION

The decision of the trial court was correct and proper in considering the facts presented and law involved and should be affirmed.

Respectfully submitted,

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STATE OF NEW YORK)
: SS:
COUNTY OF RICHMOND)

ROBERT BAILEY, being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 286 Richmond Avenue, Staten Island, N.Y. 10302. That on the 3 day of Feb 1975 deponent served the within Brief upon Attorney for Defendant

attorney(s) for ~~Res~~ Appellant

in this action, at 230 Park Ave. New York N.Y. 10017

the address designated by said attorney(s) for that purpose by depositing 3 true copies of same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States post office department within the State of New York.

ROBERT BAILEY

Sworn to before me, this
3 day of Feb 1975

William Bailey

WILLIAM BAILEY
Notary Public, State of New York
No. 43-0132945
Qualified in Richmond County
Commission Expires March 30, 1976